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Editorial Comment

*The World and
the Parliament
of Canada*

Parliament will meet shortly in what will be the fifth and presumably the last session of this nineteenth parliament. From many quarters we are told that this is a critical stage in the nation's life, not only because of the war, but also because the eve of an election forces people to think politically, and there is plenty of political material to think about just now. But is not every milestone momentous, in the life of a nation as in the life of an individual? Have we not, for thirty years back, been either bracing ourselves for a war or discussing a peace, or else hurtling into a depression or desperately scrambling to get out of it? Surely this generation is by this time inured to crises, and capable of keeping its perspective under all circumstances.

Curiously enough, the thought that is uppermost in the average mind—the steps which should be taken with a view to assuring the peace of the world—has no apparent political significance in Canada; at least no party has yet seen fit to proclaim what type of international arrangement it will advocate. This tends to concentrate all political thought and argument on the domestic issue which, almost anyone will admit, boils down to the matter of socialism. And, rightly enough, everyone concurs that it is up to the

people to decide whether or not they want socialism, and, if there is anything between whole hog or none, to indicate, as closely as can be done through a general election, just what quantity and quality of it they do want. Of course the advocates of one course or the other stress how important it is that the people realize just what is involved in this question, for which purpose they either glorify or disparage the virtues of the socialistic state, according to their own lights.

As a technical journal we are happy to leave this question in the lap of the electorate without any attempt to colour it. But we can not avoid commenting that the domestic issue, which looms so largely politically, is not entirely independent of the international issue, which we ignore politically. Of the two nations to which we constantly look for ideas, Great Britain has for centuries lived, and certainly hopes to continue to live, internationally, while in the United States the matter of isolation or its opposite has been in politics from the start. Thus while we can visualize Canada as a socialistic state, and we can equally well visualize it in the very van of an individualistic revival, we must confess inability to picture it as a Don Quixote tilting at whatever kind of world surrounds it. In short, we are likely to learn that the particular Canadian world in which we live will be determined just as much by the international world in which we will live, as by the views expressed at our own elections.

*A Refundable
Tax Dilemma*

When the refundable tax was brought into being last year, it was intended to be thoroughly non-negotiable and inalienable, so that when the right time arrived it would be paid back to the source from which it had originated. But in the course of actual administration, some variations of this principle have been developed. Thus, when a firm was in the excess profits class, and at the same time was entitled to a subsidy which was being paid by the government for the purpose of keeping selling prices down, should this firm, even though paying all of the subsidy back through its excess profits tax, be allowed to become a future beneficiary to the extent of the refundable credit? If the answer is yes, then the government is using public funds to artificially increase the amounts that will be due to many

concerns after the war. If the answer is no, then there is a charge of unfair discrimination, inasmuch as some less efficient producers get the subsidy and a credit, while others who were already in the excess profits class and who might therefore be viewed as the more efficient, are excluded from it; and, by the same token, the refundable tax thereby becomes alienable, and possibly subject to governmental pressure.

Examination Time When this issue is in the reader's hands, it will be about examination time for at least some candidates trying to qualify for the profession. The stress of war conditions, with pressure of work and uncertainty as to military obligations, is not an easy time for such a test. But there is at least one thing concerning which there is no doubt, and that is the future of the well-qualified accountant. We can not say whether the post-war period will be one of private enterprise or public enterprise, but we are on safe enough ground when we predict that it will at least be one of enterprise, for the simple reason that if individualism is given a new lease of life and is found wanting in the public viewpoint, then governments are going to take over, whether for better or for worse. If business gets away to a new start, the demand for accountants will grow at least proportionately. If state socialism prevails, the demand for accountants will be still greater, for in practically all branches of public service accounting becomes more intricate than it is in private business.

Statistical "Mirages" In a time of astronomical figures, which range all the way from the war debt (of any belligerent nation) to the war casualties (on the Russian front) we are apt to lose our sense of balance. But the fault may not be entirely in the individual's lack of perspective. There is a tendency for the figures themselves to be actually distorted—through the application, to the strange circumstances of war, of statistical methods which were devised in times of peace. The average citizen is thereby led to distrust the figures which are placed before him.

The example which is foremost in the public mind in Canada undoubtedly is the cost of living index. This index tells us that the cost of living has increased by 18½ per

cent since the beginning of the war. But hardly anyone believes it, for the simple reason that it does not accord with the experience of the housewife, who is the one most familiar with the cost of living in actual practice. It would be true, no doubt, of some hypothetical person who lived on exactly the rations which constitute the base of the index, but no real person lives in that economic straight-jacket. We all vary more or less therefrom, consuming less of this thing and more of that; and we find that the variations are costly beyond statistical computation.

To go to the other extreme, we probably have a still greater statistical mirage in the estimates of national "income". When we lived normally, and most people produced things the value of which were measured by competitive prices, we could safely enough add together the values of everything produced, and call the result the national income; we could even include the pay of public servants, at least so long as they were only a small proportion of the total, on the assumption that the public servant as a rule rendered value for what he received. But when we come to wartime production, and a very large proportion of our effort is valued by simply adding cost to cost, and there is little check by competition and none by ordinary consumer demand, the whole business gets out of hand. The very urgency of war production necessitates that in many instances the cost of an article becomes fabulous, yet it is all included in the national income. Even the pay and other costs of the armed forces have to go in.

A speaker at the convention of the American Institute of Accountants said that he could do a wonderful job of employment after the war by hiring everyone to build highways with teaspoons. With a good rate of wages per hour, that would produce a magnificent income. But it would not produce the things on which people live.

The Post-War Problem Four years of war, in a generation which delights in the idea of planning, were bound to bring some consideration of post-war schemes, but the flow of literature has become a flood, and already a "bibliography" of such literature comes to hand. A reading of a fair number of the plans fails to awaken enthusiasm or confidence concerning the future, however. There is an almost pathetic harping about "private enterprise" but nothing that prom-

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ises to resell the people on the merits of private enterprise. One does not need to be a politician, or even have his ear to the ground, to realize that the people believe that any government can give them full employment and plenty of money to spend if it really wants to, and they are consequently determined to see that they will not again be sold down the river into a depression. To suppose that the private enterprise of the past will automatically come back is to shut one's eyes to the facts of today. Private enterprise just now is out of favour, and nothing short of a blitz will restore it.

There is, for example, the unquestioned problem of employment after the war. Take all the pent-up demand, and all the new inventions, and all the workable co-operation that has been devised in the course of the war, and add them together, and it is still difficult to figure enough jobs for all the people who are in the armed forces and in the war industries today; and that is on the basis of ample capital, credit and profit incentive. In other words, give a concern a free hand with a product, and let it keep all of the profit, and still the amount of labour and raw material which it can expect to absorb in the estimable future is limited.

One obvious probability is that whatever government is in power at the critical time will recognize some merit and some votes in the idea of private enterprise, but just enough to warrant a slight concession in its favour. Whereas in fact, the revival of peacetime production and employment is so enormous a task that no half measures will suffice. A mere modification of corporation and personal income taxes will do no more than place upon industry an apparent responsibility for the future, without the ability to make good. And that would tend to drive public opinion, more definitely towards state socialism. So, if we do want to live freely and individually, we will have to devise something which is much more powerful in its appeal than anything which is at present in the public eye. We must be able to guarantee that every person who wants a job can have a job, and that every farmer can sell every ounce of his output. Of course there has to be bitter with the sweet, and it would be a highly competitive world. But at least there would be the offer of freedom as opposed to the state socialist's control. And then it would be up to the voter to choose his fate.

Staff Training

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(Last year Messrs. Clarkson, Gordon, Dilworth & Nash made available to THE CANADIAN CHARTERED ACCOUNTANT a series of articles prepared for their staff training course by various partners and members of their staff. The course was modified this year in some respects and an additional article appears in the current issue of this magazine. At the request of the Editorial Committee Mr. H. C. Dell, who was in charge of the staff instruction course, explains how it was given and the results which were achieved.)

IN the years before the war the junior audit clerk worked during the day under the direct supervision of experienced accountants who had the time to explain to him the auditing and accounting problems which he encountered from time to time. In addition he spent several evenings a week studying the course of instruction which it was necessary for him to complete before he was permitted to write the examinations of the institutes of chartered accountants. Furthermore, many students spent at least some time reading accounting magazines, books, etc., in addition to those actually prescribed by the course. As a result of the war many firms of chartered accountants are now employing a large number of clerks who are not taking the course leading to membership in any institute. Furthermore, the supply of trained accountants employed by the various firms has been reduced and the remaining experienced men no longer find it possible to spend as much time as formerly instructing the new and inexperienced clerks. In addition it is important under present conditions for the new clerks to progress to the stage of experienced juniors and intermediates in a shorter time than was formerly the case, in order that these new people may be qualified to fill vacant positions created through large numbers of men leaving to enter the armed services.

To meet these changed conditions we instituted a staff training programme in the Fall of 1942, the results of which were so successful that a somewhat similar programme was carried out in the Fall of 1943. In addition to the obvious benefits to be derived from having a better trained staff it was also found that the individual members of the staff are better satisfied, because they now find their work more

interesting since they have a clearer understanding of the reasons for performing the work they do from day to day. Although the staff training programme was started as a war measure, the results have been so satisfactory that we expect to continue it after the war with benefits accruing both to the students and to ourselves. Under the changed conditions which will prevail after the war, we will undoubtedly find it necessary to revise the course of instruction to meet the requirements of the staff which we will have at that time.

1942 Programme

Last year we decided, as an experiment, to concentrate all of our staff training into one week. Each afternoon a lecture on a particular subject was delivered to all members of the staff who had not already qualified as chartered accountants. This took approximately one and one-half hours and, after a recess of fifteen minutes, the class was divided into several small discussion groups for another one and one-half hours. After the discussion a short test was given to the students. We found, however, that we were trying to concentrate altogether too much effort into too short a space of time and this year our programme was changed to try to eliminate the weaknesses of the preceding year.

1943 Programme

This year the course consisted of eight subjects divided into two sections as follows:

Junior Section:

- Bookkeeping
- Auditing cash and banking transactions
- Auditing the non-cash records
- Balance sheet schedules and working papers for the junior.

Intermediate Section:

- Internal check and fraud
- Balance sheet procedure
- Audit working papers
- Corporation taxes and taxable income

Eight consecutive Saturday mornings were devoted to the study of these eight subjects. The task of assigning each student to the junior or intermediate or both sections of the course was left to that particular student's staff senior.

Generally speaking, employees with less than a year's experience were required to take the junior course, while those who had more than a year's experience, but who had not yet tried their final examinations attended the intermediate course. Reading material for each subject was handed out to the students one week in advance in order that they might come to the discussion group fully prepared.

Discussion Groups

Each discussion group consisted of ten students with an experienced chartered accountant as its leader. Three hours were spent on discussion, a recess of fifteen minutes being given half way through the morning. In order that each discussion group might cover approximately the same ground, "Material for Discussion" was prepared in advance and handed out to the discussion group leaders a week before the discussion took place. This "Material for Discussion" indicated the approximate time to be spent on each section of the subject in order that all discussion groups would finish at approximately the same time. The method of approach employed in the discussion groups varied somewhat according to the particular subject being discussed.

Tests

A short test of from ten to thirty minutes followed the discussion groups. These tests did not follow any set pattern but were varied to suit the requirements of the particular subject for which the test was set. The tests were designed to disclose, as far as possible, the students' knowledge of the most important points covered in the reading material and discussion group. The papers were marked and returned to each staff head the following morning together with a set of model answers in order that during the next day or two he might discuss the errors with the members of his staff and make sure that they learned the correct answers. Examinations may be a poor measure of a man's ability but it was decided that they were necessary in this case to provide an incentive to study, to determine the points on which the students were not clear and to assist us in appraising the effectiveness of the training programme.

Follow-up

At the end of the last discussion group the students

were supplied with additional reading material entitled "Highlights of Auditing and Balance Sheet Procedure" which summarized the material they had been studying during the previous eight weeks. We felt that this summary would clarify any points which might not be clear in their minds. At the same time they were given a questionnaire asking them specifically what they thought of various parts of the staff training programme and also requesting them to make any suggestions which they thought would improve future courses of a similar nature. This type of questionnaire had been used in 1942 and was found to be extremely helpful in arranging the 1943 programme.

Conclusion

The staff training programme has involved a very considerable amount of work, but we feel that the results have more than justified the efforts. It is not a substitute for practical experience but it has enabled us to find out with a reasonable amount of accuracy what each person knows and what are his weaknesses. With this knowledge we can then make certain that he gets the proper supervision. As a result of the training programme our clerks now not only approach their work in a more intelligent manner than formerly, but also perform their work more rapidly. We also find that he have instilled in many of them the desire for knowledge, with the result that they are re-reading the material with which they have been provided in order to understand the fundamentals of audit procedure thoroughly. Another benefit is that the reading material serves as a reference book which the student uses to work out many problems which formerly would have had to be solved by discussion with one of his seniors.

It is realized that this training programme could be improved considerably, particularly if it were possible to double or triple the length of time spent in the discussion groups. In view of the practical difficulties involved, however, we are sufficiently satisfied with the present programme to continue it in more or less the same form next year with, we hope, an added section for seniors which would cover such subjects as accounting principles, auditing standards, Securities and Exchange Commission requirements and involved taxation problems.

Corporation Income and Excess Profits Taxes in Canada

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(This paper is supplementary to the staff training series which was published in THE CANADIAN CHARTERED ACCOUNTANT from December 1942 to April 1943 inclusive, and which was reprinted in booklet form under the title "Audit Procedure for the Junior Audit Clerk").

WHILE there are many fields of taxation, this paper is limited to a brief discussion of the taxation of income and excess profits in Canada as applied to incorporated companies, with particular reference to the duties and problems of the auditors in connection therewith. All three forms of government in Canada, municipal, provincial and federal, have the power to impose income taxes and have made use of this power. As for the most part the provinces and municipalities have suspended their taxes on income for the duration of the war (the only major exception being a provincial tax on mining activities which is still imposed), only those taxes on income which are imposed by the federal government will be considered.

Dominion taxes on income and excess profits are imposed by two acts—the Income War Tax Act which has been in operation continuously since 1917 and the Excess Profits Tax Act, 1940. During its life of over a quarter of a century, the former Act has been the object of continued revision, having been amended on some thirty-four occasions to meet changing conditions and to correct deficiencies. The Excess Profits Tax Act has similarly been amended each year since it was first passed.

The Income War Tax Act has been the subject of a number of judicial decisions arising out of appealed assessments and while some of these have become obsolete as a result of subsequent amendments to the Act, others are a useful guide to the exact meaning of certain sections of the Act as it now stands. There is also available as a guide a very considerable body of court decisions dealing with other statutes of a similar nature or in which similar language is used.

There are many problems which arise from time to time as to the exact meaning of the Act which have not been

decided by the courts and on which it is necessary to find out the interpretation placed on the Act by the Income Tax Division. In addition, both acts give discretion to the Minister on certain matters such as depreciation rates, etc., many of which have been the subject of rulings of the commissioner in the past; these rulings are of course important.

It will be seen from the foregoing that to apply these statutes to a specific case it is frequently necessary to refer not only to the Act itself, but to legal decisions and to the commissioner's general rulings; sometimes it is also necessary to ask the department for specific rulings covering the point in question and/or to obtain independent legal advice.

Position of the Auditor

The auditor is engaged by and works for the shareholders of the company and he must always remember that his first duty is to his client. Before he can report to the shareholders on the correctness of the balance sheet the auditor must ascertain the adequacy or otherwise of the provision for taxes. To satisfy himself on this he must have an adequate knowledge of the law, not only as regards the rates of tax in force, but also as to the base on which the tax should be applied. Without this knowledge or without a knowledge of what is included in the accounts, he cannot express a fair opinion as to the adequacy of the tax reserves. While we are acting primarily for our clients and not for the taking authorities, it must not be lost sight of that we have a general duty to ourselves and our profession to see that material facts affecting taxes are properly disclosed in the operating accounts—in this connection we will be required to sign certain factual reports for the specific use of the Income Tax Department.

Frequently we, as auditors, are asked to prepare tax returns for our clients and here too it is important that we have sufficient knowledge, both of the law and the facts, to prepare the returns accurately. Recently the Commissioner of Income Tax has drafted a new tax return (the T.2 Questionnaire) which is required to be filed by all incorporated taxpayers. This return consists of a considerable number of questions which the taxpayer is required to answer; the taxpayer's auditor is then required to report to the tax department as to the accuracy of the answers

given to the best of his knowledge and belief. The various questions are designed to obtain information about the accounts of each company which the department obtained in the past by sending in its own assessors to examine the taxpayer's records.

You will see from the above that we must have more than a nodding acquaintance with the law (including legal decisions and the commissioner's rulings) to carry out our duties to our clients.

The Statutes

The Income War Tax Act imposes a tax on "income" as defined in the Act. In its present form this statute consists of some seventeen parts and two schedules, the seventeen parts comprising almost one hundred sections. The Excess Profits Tax Act, while an entirely separate document, may readily be looked on as an extension of the Income War Tax Act imposing additional taxes on "profits" on various bases. The very close relationship between the two acts is obvious when it is considered that "profits" as defined in the Excess Profits Tax Act mean the net taxable income as determined under the provisions of the Income War Tax Act. Furthermore, almost fifty sections of the Income War Tax Act are made equally applicable to the Excess Profits Tax Act.

While it is not expected that all members of the staff will become authorities on income and excess profits taxes, they should become sufficiently familiar with the general framework of both acts and with the principal forms to make tax calculations and prepare returns with a minimum of supervision. In particular, all should have a fairly detailed knowledge of the sections of the Income War Tax Act dealing with the determination of taxable income (Sections 3 to 6).

Income War Tax Act. This Act commences by defining a number of the terms used therein, and continues with seventeen parts and two schedules which may be summarized as follows:

- Part I—Definition of taxable income (Section 3).
- Part II—Exemptions and deductions (Sections 4 to 8).
- Part III—Charging provisions (Sections 9 to 9B).
- Part IV—Special provisions relating to the incidence of the tax (Sections 10 to 32B). This part sets out certain

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special rules dealing with the taxation of estates, trusts, partnerships, personal corporations and non-residents: it also deals with corporate reorganizations, attempts to evade taxation, etc.

Part V—Returns (Sections 33 to 47). This part imposes on all taxpayers the duty of filing annual returns; it also provides for information returns to be filed by certain other persons.

Part VI—Payment of tax (Sections 48 to 53). These sections set out the manner in which tax must be paid, dates of payment, etc.

Parts VII to X—Administration of the Act (Sections 54 to 76A). These parts deal with the procedure followed by the department in making its assessment, the manner of making appeals, remedies of the Crown to recover taxes, etc.

Part XI—Offences and penalties (Sections 77 to 87). These sections impose penalties for failure to file returns, false statements, failure to collect taxes at the source, etc.

Parts XII to XV—These parts (Sections 88 to 91) deal with certain special matters which are not of general interest or which (like the National Defence Tax) are no longer operative.

Part XVI—Tax deduction at the source (Section 92).

Part XVII—Refundable portion of tax (Section 93). This part is only applicable to individuals.

The first of the two schedules sets out the rates of tax (corporation rates are included in paragraphs C, D and E). The second schedule is merely the form for filing appeals.

Excess Profits Tax Act, 1940. This Act consists of some eighteen sections and two schedules and is a much shorter document than the Income War Tax Act. As many provisions of the Income War Tax Act apply equally to the Excess Profits Tax Act, an understanding of the latter is dependent upon a knowledge of the contents of the older statute.

Calculation of Taxes

The calculation of taxes under both Acts starts with determination of taxable income. Income is defined at some length in Section 3 of the Income War Tax Act and so far as companies are concerned consists basically of the

annual or periodical net profit from the operations of the business. The definition of income also includes many specific items, most of which are of chief interest to individual taxpayers rather than to corporations. The Act also sets out certain rules for the determination of "income" which in some cases vary from the ordinary commercial concept.

Rates of Tax. Immediately after the commencement of the present war, the rate of tax imposed on corporations by the Income War Tax Act was increased to 18% (20% in the case of companies which file consolidated returns) and this rate, which is still in force, is applied on "net taxable income."

The Excess Profits Tax Act, as originally enacted, called for payment of the greater of 12% of total profits (i.e., net taxable income) or 75% of excess profits. In computing the maximum tax, excess profits is first reduced by deducting the income tax already paid thereon and thus this maximum tax is really a net tax of 61½%, (60% for consolidations), viz.:

Single companies—

$$75\% \text{ of } (100\% - 18\%) = 75\% \text{ of } 82\% = 61\frac{1}{2}\%;$$

Consolidations—

$$75\% \text{ of } (100\% - 20\%) = 75\% \text{ of } 80\% = 60\%.$$

These rates applied to profits deemed earned in the calendar year 1940. It will be observed that the combination of income and excess profits taxes resulted in a minimum tax of 30% (18% plus 12%) and a maximum tax of 79½% (18% plus 61½%)—these become 32% and 80% respectively for consolidations. In 1941 the minimum excess profits tax rate for corporations was increased to 22% and this remained in force until 30th June 1942: this change increased the minimum combined rate to 40% (42% for consolidations) but did not affect the maximum rate. As from 30th June 1942 the minimum 22% excess profits tax rate was split into two parts—a 12% rate imposed on taxable income, which must be paid by every company (having exactly the same effect as if it had been added to the income tax rate) and a 10% rate which was left as the alternative to the maximum rate; at the same time the maximum rate was increased to 100% of which 20% is refundable after the war. These rates are still in force and

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are wholly applicable to the profits of years commencing on or after 1st July 1942. They are also applicable in part to the profits of years which commenced prior to but ended after that date. It will be seen that under the statutes as they now stand the combined rates range from the same minimum as prior to 30th June 1942 (viz., 40% or 42%) to a maximum of 100%.

It will be noted that the combined taxes imposed from time to time could be expressed in each case as a total of two figures, viz., a minimum rate applicable to each dollar of profits up to a "breaking-point" (where the alternate taxes under the Excess Profits Tax Act are equal) plus a maximum rate applicable to each additional dollar of profits above that point. As "excess profits" on which the maximum rate is applied is determined by reference to normal or "standard profits", the breaking-point can be expressed as a percentage of standard profits. This percentage has varied as follows:

	<i>Separate returns</i>	<i>Consolidated returns</i>
Under 1940 rates (applies to 1940) ..	124.242%	125 %
Under 1941 rates (applies to 1941 and up to 30th June 1942)	155.696	157.895
Under 1942 rates (applies after 30th June 1942)	116-2/3	117.241

For instance, under the 1942 rates, with standard profits of \$6,000, the "breaking-point" at which the alternate taxes are equal would be \$7,000 ($116\frac{2}{3}\%$ of \$6,000).

Proof:

Minimum tax		
10% of profits of \$7,000	=	<u>\$700</u>
Maximum tax		
Profits	\$ 7,000	
Standard profits	<u>6,000</u>	
Excess profits	1,000	
Less mandatory tax applicable thereto:		
Income tax	18%	
Excess profits tax	<u>12%</u>	
	30% or	300
Taxable excess profits	<u>\$ 700</u>	
Tax at 100% thereon		<u>\$700</u>

The use of this breaking-point simplifies calculations of taxes for working paper purposes although the longer

method of calculating the taxes in detail must be used on the actual tax returns. Even on the tax returns it is necessary to use the breaking-point, in the case of years ended after 30th June 1942, to determine the post-war refund.

The following is an example of the calculation of tax for a year which ended on 31st December 1942 (it will be observed that this involves the application of both the present and the former rates). In the example it is assumed that profits for the year amounted to \$36,500 and standard profits were \$10,000.

Preliminary Step. As part of this period occurred before 30th June 1942, a preliminary step is required to apportion both the profits and the standard profits on a daily basis, as follows:

	Total	Pre 30th June 1942	Post 30th June 1942
Number of days ..	365	181	184
Profits	\$36,500.00	\$18,100.00	\$18,400.00
Standard profits ..	10,000.00	4,958.90	5,041.10

Tax Calculation

I. Tax on profits deemed earned up to 30th June 1942:

	Profits	Taxes
Profits subject to minimum rate (15.696% of \$4,958.90)	\$ 7,720.82	
Tax thereon at 40%		\$ 3,088.33
Profits subject to maximum rate (the balance)	10,379.18	
Tax thereon at 79.5%		8,251.45
Total	\$18,100.00	\$11,339.78

II. Tax on profits deemed earned after 30th June 1942:

	Profits	Taxes
Profits subject to minimum rate (116.2/3% of \$5,041.10)	\$ 5,881.28	
Tax thereon at 40%		\$ 2,352.51
Profits subject to maximum rate (the balance)	12,518.72	
Tax thereon at 100%		12,518.72 (x)
Total	\$18,400.00	\$14,871.23
Total for the whole year ..	\$36,500.00	\$26,211.01 (y)

(x) 20% of this \$12,518.72 is the post-war refund, i.e., \$2,503.74.

(y) Of this tax \$6,570 is the income tax (18% of the total profit of \$36,500) and the balance \$19,641.01 is the excess profits tax.

Note: It will be seen that Part II above would by itself serve as an example for a year which commenced after 30th June 1942.

Net Taxable Income

As indicated previously correct determination of net taxable income is necessary to arrive at a basis for com-

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puting all taxes under both Acts. For all practical purposes net taxable income may be defined as the income for the accounting period (determined under various rules set out in the Income War Tax Act as to deductions which are or are not permitted) less certain statutory exemptions. The bulk of the provisions dealing with these exemptions and deductions are contained in Sections 4 to 6 of the Income War Tax Act; the more important of these which affect companies are indicated below:

Exempt Income (Section 4). The most important exemption under this section is under paragraph (n) which exempts dividends received from another Canadian company (except a few companies like the Brazilian Traction Company and International Petroleum Company, which are not subject to Canadian income tax). There is a somewhat similar provision in paragraph (o) which, however, is seldom encountered, which exempts a proportionate part of dividends received from foreign companies if those foreign companies pay taxes in Canada. The section also completely exempts from taxation, on grounds of policy, the incomes of certain municipal undertakings, charitable institutions, labour organizations, clubs, etc.

Deductions Specifically Permitted (Section 5). The following paragraphs are the more important of those which apply to companies:

- (a) amounts provided as a reserve for depletion, in the case of companies whose assets are of a wasting nature (e.g., mines, oil wells, timber limits). These allowances are limited by various departmental regulations;
- (b) interest on borrowed capital such as bonds outstanding, mortgages payable, etc., at a rate subject to the Minister's approval;
- (ff) &
- (m) certain limited contributions to employees' pension funds which have received departmental approval;
- (jj) charitable donations (limited to 5% of income);
- (p) business losses of the immediately preceding year (this paragraph was added by the 1942 amendments to the Act: it is an entirely new principle in Canada).

Deductions Not Permitted (Section 6). The chief paragraphs applying to companies are:

- (a) expenses not "wholly, exclusively and necessarily" incurred to earn income;
- (b) capital losses (other than the depreciation or depletion provisions permitted by other sections of the Act);
- (d) provisions for contingent liabilities (other than limited reserves for bad debts);
- (e) &
- (h) carrying charges on unproductive property, or on property producing tax exempt income;
- (i) certain expenses payable to a controlling company abroad unless the Minister is satisfied that the charge is a proper one;
- (k) interest on income bonds or income debentures;
- (m) salary in excess of \$14,000 paid to a non-resident (unless the non-resident pays Canadian income tax on the salary);
- (n) depreciation provisions—except such amount as the Minister permits.

Under sub-sections 2 and 5 of Section 6, the Minister is given power to disallow expense payments which he considers excessive and to apportion expenses which are incurred partly to earn taxable income and partly to earn non-taxable income.

In determining taxable income the deduction of income and excess profits taxes is not allowed, it being considered that paragraph (a) mentioned above is quite wide enough to prohibit the deduction and that in any case these taxes are a distribution of the net income rather than a deduction to be made in arriving at net income.

Definitions. The chief definitions which should be kept in mind concern—

1. "Net taxable income". This has been discussed above.
2. "Profits". This is a term used in the Excess Profits Tax Act and is synonymous with net taxable income referred to above.
3. "Excess Profits". Excess profits means the amount by which profits exceeds normal or "standard profits".
4. "Standard profits". There are a number of sections

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of the Excess Profits Tax Act dealing with the determination of standard profits. Standard profits usually are determined by reference to the earnings of some or all of the years 1936 to 1939. In certain circumstances, however, they may be settled by agreement between the taxpayer and the income tax division or by a finding of the Board of Referees (a board set up to deal with exceptional cases such as new businesses and those which were abnormally depressed during the years 1936 to 1939). Standard profits cannot be less than \$5,000 and this figure will be frequently used by small businesses.

Forms. There are a number of forms in use which you may be asked to prepare, most of which you will find quite simple and self-explanatory. The chief forms with which you will be concerned are form T.2 (the return of taxable income for corporations) and form T.2 Questionnaire, both of which will receive particular attention in the discussion groups. To understand the reason for many of the questions on these forms you should have a knowledge of certain sections of the Income War Tax Act—particularly sections 3, 4, 5, 6 and 9. These sections and the above mentioned forms should be studied carefully before the group discussions.

Provincial News

Quebec

At the annual meeting of the Quebec City Committee of The Society of Chartered Accountants of the Province of Quebec the following members were elected to the council for 1943-44: President, Jacques LaRue; vice-president, Paul Bruneau; secretary-treasurer, Gustave-E. Tremblay; directors, Georges-Henri Boulet (de facto), Real Rondeau, Roland Chagnon, Lionel Roussin and Cyrille Belanger.

Saskatchewan

The Regina Chartered Accountants' Club held the first regular luncheon-meeting of the fall and winter season at the Kitchener Hotel on Thursday, 28th October.

The following members were elected as officers for the ensuing year: President, Clair H. Smith; vice-president, O.

L. Bicknell, executive members, I. E. Basin and H. A. Randal; and secretary-treasurer, J. E. Rowsom.

The executive is planning a series of monthly luncheon-meetings and addresses on subjects of particular interest to the members.

Prime Material Control Without the Use of Detailed Perpetual Inventory Records

By Harry E. Clayton
Chartered Accountant
Toronto, Ontario

THE purpose of this brief article is to bring to the foreground, for discussion purposes, the question of whether or not material control can be achieved without the use of the generally accepted perpetual inventory records.

It is the writer's opinion that control of prime materials can be readily effected without these records for all products which are manufactured on a mass production basis. However, it is not practicable to adopt this procedure for stock which is consumed in the production of individual custom-built articles, as the effort needed is, generally speaking, at least as great as that required to operate detailed perpetual inventory records because of the necessity of developing a bill of material for each specific order. Furthermore, as the title indicates, the remarks contained herein do not apply to the control of factory supplies, as the difficulty of estimating the life of some of these supplies necessitates the use of the regular stores records. The justification for this essay, however, lies in the fact that the greater portion of materials purchased by industry become the prime materials of mass production, and it would therefore appear that much effort could be eliminated if the perpetual inventory data relating to such materials could be dispensed with.

Weaknesses of Perpetual Inventory

Before reviewing the method by which these records can be eliminated, attention is directed to their chief disadvantage, which is, in my opinion, the large expenditures of time and money required in relation to the benefits de-

rived therefrom. Due to the tremendous volume of detailed work required on these subsidiary records, it has been the general policy of industry to direct the work of the lower-paid employees along these channels, in order to reduce the cost of maintaining such records. In many instances, the results of this procedure are clearly indicated in the unsatisfactory manner in which the data is accumulated. This state of affairs, however, is generally not fully known to management until a complete and accurate physical inventory is taken and a discrepancy noted between the physical count and the book quantities, at which time a decision must be made as to whether or not (a) the book work previously performed should be all re-checked, in order to substantiate or prove the inaccuracy of the existing book records, or (b) the recording of book quantities should be taken as read.

Irrespective of which procedure the management follows, the results will not be entirely satisfactory. Suppose it is decided to re-check the subsidiary inventory data, and that after making the necessary corrections a difference still exists between it and the physical count; the revised book figures have now been substantiated, and the difference must, of course, be the result of shrinkage in stock due to pilferage, providing all wastage and over-run factors have been properly computed and duly recorded. (Note that if both the perpetual inventories and the physical count are correct, no inventory overage can occur). The management can therefore only adjust the quantity records, value the loss relative thereto which must be written off against operations, and endeavour to enforce a more rigid physical control in the future, in order to stop such pilferage, which is, to a large extent, a case of "locking the stable after the horse has been stolen." If the second course of action is taken, results in so far as the difference is concerned are the same, except that the management will not know whether the difference is attributable to the incorrect recording of book quantities, pilferage, or a combination of both factors, as the book records were not re-checked to substantiate their accuracy.

The use of perpetual inventory records also presupposes the operation of stores requisitions which are individually posted to such subsidiary records, while the accumulated total dollar value of same forms the basis for any entry in

the general books of account. Under this system the authority for requisitioning the materials, and charging them against specific jobs, generally lies with the foreman in charge, who, in the course of his routine job, may tend to approve such requisitions in an automatic manner, with the result that more materials may be requisitioned for a job than are actually needed. What sort of control can the management exert over this state of affairs? For example, let us suppose that it requires ten units of material to make an order, yet the foreman approves the requisitioning of fifteen units. How will the management be aware of this situation unless it keeps a bill of material for each job, so that it may determine the number of units required? This brings us to the point in question. If a bill of material is kept, then it is my opinion that the maintaining of both the docket system and the perpetual inventory records results in a duplication of work which cannot be justified.

A Workable Alternative

A successful material control can, in the writer's opinion, be maintained by the correct development and use of production reports and bills of material providing they are adequately supported by a rigid physical control of the material. The operation of this procedure in its most simplified form is effected in the following manner:

(a) Materials purchased or manufactured are accumulated in one material account in which they remain until they are sold.

(b) These sales are relieved from the above account and charged to cost of sales on the basis of a priced bill of material.

(c) The quantity and type of material rejected in manufacturing operations is obtained from the production reports, priced from the aforementioned bill of material and relieved from the material account by charging an appropriate expense or cost of sales account depending upon the circumstances of the particular case.

(d) The balance remaining in the material account represents the value of raw material, material in process, and material in finished production still on hand.

The quantities of any specific type of material that should be on hand can be readily determined by taking the total of such stock purchased and manufactured and de-

PRIME MATERIAL CONTROL

ducting therefrom the total of same which has been absorbed in products sold and rejected. For example let us suppose that on December 31, 1942, a physical inventory showed that there were 100 net tons of material "A" on hand and that the total purchases of same for the six months ended June 30, 1943, amounted to 50 net tons. A review of the company's month-end entries for the same six months indicates sales and rejects to be as follows:

Product	No. of Units Sold	No. of Units Rejected	Total (Sales and Rejects)
D	300	10	310
E	400	30	430
F	200	5	205
G	700	55	755
H	1,000	100	1,100
I	5,000	400	5,400

Perusal of the various bills of material show that the quantities of material "A" required per unit of product are:

Product	Quantity of Material Per Unit of Product
D	10 lbs.
E	20 lbs.
F	Nil
G	20 lbs.
H	50 lbs.
I	10 lbs.

It is therefore obvious that the total material "A" absorbed in sales and rejects during the six months ended June 30, 1943, amounts to 67-9/10 net tons, details of which are as follows:

Re Product D	10 lbs. x	310	=	3,100 lbs.
E	20 lbs. x	430	=	8,600 lbs.
F	Nil		=	Nil lbs.
G	20 lbs. x	755	=	15,100 lbs.
H	50 lbs. x	1,100	=	55,000 lbs.
I	10 lbs. x	5,400	=	54,000 lbs.

135,800 lbs. or
67-9/10 net tons

Deducting the above consumption of 67-9/10 net tons from the inventory plus purchases leaves 82-1/10 net tons that should be on hand either in raw stock, work in process or finished units. The exact stage of production in which the material actually is located can, of course, be determined by a mathematical calculation of the necessary data recorded on the production reports and bills of material similar to the one shown above.

Realizability

If management desires to keep a book segregation of inventories according to the various phases of realizability, this can readily be accomplished with comparatively little additional work, by:

- (a) Charging all material purchases to a raw material account which can be relieved periodically by the use of one blanket requisition for all materials put into process during such period as developed from the production reports and bills of material.
- (b) Relieving the material process account on a bill of material basis for all finished units as indicated by the production reports and charging an appropriate finished goods account.
- (c) Debiting the material reject costs to an appropriate expense or cost of sales account, depending upon the particular circumstances of the case, and crediting the material process account. As previously stated, the quantity and type of material rejected during the manufacturing operations is obtained from the production reports and priced from the aforementioned bill of material.
- (d) Charging cost of sales and relieving the finished goods account in the regular manner.

Some may say that the procedure outlined above necessitates the maintaining of bills of material and production records which would not be required if the regular detailed perpetual inventory records were in use and that, therefore, the saving in clerical services is negligible. With this line of thought the writer cannot agree because, as previously stated, the development of such data is a prerequisite to efficient management control irrespective of whether or not perpetual inventories are in use. A portion of the effort thus saved can generally be well utilized in effecting a more rigid physical control over materials because, in the final analysis, the ultimate success of any stock control system depends upon the efficiency with which this phase of the work is carried out.

Under the material control system reviewed above, prime materials are generally purchased in "lots" which will be consumed in the production of a specified number of finished units of production although deliveries may be received on a "piece meal" basis as they are required in

the plant. Furthermore, purchases are only made after conferring with the production planning department as to anticipated production during the current season. This correlation of purchases and production consequently curtails, to a large extent, the possibility of plant shut-downs due to lack of material. In addition, shortages automatically come to the fore so that the proper corrective measures can be applied to "leakages" or "wastages" as they occur.

Tried With Success

The aforementioned principles have all been successfully applied in practice. In one instance a large concern found it necessary to dispense with perpetual inventory records because:

(a) The costs of maintaining such records were becoming prohibitive.

(b) Their accuracy could not be depended upon and this, coupled with the fact that it did not seem to be possible to keep them up to date, rendered them useless in so far as the determination of purchase requirements was concerned. This firm then adopted a system similar to the one outlined above, and since that time have had annual inventory adjustments ranging from one and one-half per cent to one fortieth of one per cent of the inventory valuation. Furthermore, purchasing efficiency has increased, whereas the clerical cost of controlling materials has considerably decreased.

In closing, I would like to point out that the system outlined above can be applied in its various aspects to numerous situations. For instance, it is sometimes found advisable to record all purchases of prime materials on the books at a standard cost. Under this method, price variances, which are created at the time of purchase, are generally subdivided either by product or type of material and are allocated to inventories and cost of sales on a *pro rata* basis in order to arrive at the actual cost relating thereto. It should be noted, however, that the variances applicable to the above costs are not entered in those accounts but are recorded in separately designated price variance accounts. The inventories are, therefore, always shown separately in the records at standard cost and, consequently, when an accurate physical inventory is taken and valued at such standard, the adjustment necessitated between the book

records and the valuation of the physical count is truly an inventory adjustment and not a combination of both an inventory and price adjustment, as is usually the case. However, the major advantage lies in the fact that the prices on the bills of material, which are used for costing purposes, are not subject to continual revision, so that once a bill of material is developed and valued at the standard cost figures, no further work is required in connection therewith until either the standard cost or the bill of material is changed.

NOTE:—The opinions expressed in the foregoing article are those of the writer and are not necessarily endorsed by any Department of the Government.

Financial Statement Reform

By F. S. Capon
Chartered Accountant
Montreal, P.Q.

THE main functions of accountants continue to be the recording of financial information and the subsequent preparation of reports and other statistical data on the results obtained by management, despite the recent rapid development of various specialized technical fields. The duties of recording transactions, and often of preparing financial statements, rest largely with industrial accountants, but the grave public responsibility for verifying the accuracy of periodic statutory reports by management to owners lies with professional accountants. In addition, the accounting profession is expected to develop and publicize accounting standards and principles. A considerable amount of criticism has recently been levelled at the profession in Canada and Great Britain, both by members and by others. Some further criticisms by an industrial accountant, which it is hoped may be constructive, are submitted herewith. These suggestions are by no means exhaustive, but are intended to give an indication to desirable types of revisions to present practices.

Present Forms Too Rigid?

The authority and responsibilities of the public accountant are governed by the provisions of the Companies' Act which attempts to list in detail the items that must be

segregated in official financial statements. It is obviously impossible to cover adequately all the items that should properly be segregated in any particular case, however, with the result that it is frequently possible to avoid making significant disclosures without violating the letter of the law. In such cases, auditors are accused of yielding to the insistence of management, stalling their conscience by stressing that the Act did not specifically require the item to be shown. Furthermore, the detailed accounting requirements of the Act have caused a rigid form of financial statement to be developed over a period of years, and most statements which conform with the minimum requirements are for the most part unintelligible to all but trained accountants. In order to improve the form of financial statements, which are the prime responsibility of accountants, and also to strengthen the hands of public accountants, it appears to be necessary to make widespread amendments to the Act.

"Popular" Versions

Audited financial statements for the past year are the only documents required to be submitted to shareholders by management, but it is becoming increasingly apparent that financial statements alone are entirely inadequate if management is to give a really informative account of its stewardship. Enlightened managements are now rapidly developing informative annual reports, and the financial statements required by law are being relegated to the back pages. By way of such reports, it is possible to explain each year to investors, employees, customers and the public at large, all of whom are vitally interested in the results of large companies, the developments that have taken place, together with interpretations and forecasts, whereas it is quite impossible to give such information in financial statements. It is doubtful if such informative reports will become universal unless they are made compulsory, and if this could be achieved auditors could take into account the directors' report, thus avoiding unnecessary complications in the financial statements.

Comparative Figures

Financial statements for one year are of little value, since the trend of revenue and asset changes over a period of years is vastly more important than the results for any

one year. Earning power, the key factor for investors, cannot be measured by looking at statements for one year, and trends are equally vital for credit and other purposes. There is an increasing tendency to publish comparative figures in annual statements, but the desired end will probably never be achieved without inserting a statutory requirement in the Act. A five-year comparison is probably adequate, and it must be stressed that it would not be necessary to give a complete income and balance sheet comparison for such a period. In order to avoid a mass of figures, it would be sufficient to compare major assets and liabilities comprising, say, 80% of the balance sheet totals.

"Balance Sheet" Totals

Balance sheets consist of several groups of assets and liabilities, each valued on different bases. In other words the totals of assets or liabilities shown in the balance sheet represent the sum of unlike figures and are therefore meaningless. This custom of reproducing the trial balance has become completely rigid over the years, and it is probably the greatest factor causing the present unintelligible form of financial statements. Since statements are certified by both auditors and directors, it is surely not necessary to produce balancing totals for debits and credits to prove that no items are omitted. It is therefore suggested that a set of schedules, each covering a different group of balance sheet items, giving careful explanations of bases for valuation, etc., would be far more informative to all readers, including the trained accountants. Emphasis on such facts that so-called "fixed assets" are in effect nothing better than deferred charges to operations, and that many other figures are estimates based on the judgment of management, would be possible in a more informal statement or set of schedules, and would assist greatly in giving untrained readers a real grasp of the meaning of the statements. It appears that an amendment to the Act would not be required to make major improvements in the existing traditional form of statements, and even the mere substitution of such a term as "Statement of Financial Condition" for the archaic "Balance Sheet" might facilitate a break from the present hidebound accounting forms and procedures.

Estimates Pre-dominate

The remark that many, if not all, asset and liability figures depend on judgment, leads to a further major criticism of present statements. Because of the complexity of corporation accounting, it is quite impossible to produce exact figures for revenue, costs, expenses, assets or liabilities at any given date, and financial statements are necessarily based to a very great extent on the judgment of the management. A figure of, say \$10,167,218.82 for inventories or \$15,617,421.93 for plant, buildings and equipment gives the impression that these assets have been examined with the utmost care and that the stated values are correct to the nearest cent. In effect, the inventory may or may not have been physically counted, and in any event valuation is based largely on estimates, while plant investment is probably valued at cost and the stated value may have little relationship to present day market or realizable value.

The statement of such estimated or approximate values to the nearest cent gives an entirely erroneous impression of accuracy, whereas the statement of all figures to, say, the nearest thousand dollars would not detract from the value of the statements, and would emphasize to readers that the figures were estimates based on the judgment or opinions of management. Furthermore, a considerable amount of confusion caused by attempts to adjust minor errors discovered at the last minute could be avoided as the need for correction would largely cease.

Prior Year Surplus Adjustments

Establishment of the principle of approximating figures might help considerably towards the banishment of another bone of contention—prior year surplus adjustments. The Act states that surplus account must show clearly adjustments to prior year earnings, and gives no discretion as to the size of adjustments that might not be brought out. Because statements for any given period are only approximations, it stands to reason that the following period must of necessity include a number of items affecting prior periods. To disclose all such adjustments would be to make the accounts almost unintelligible to most readers, and would at the same time cause many unfair criticisms of the judgment of management. It is suggested that net profit for any one year should be the increase in net assets value

during the year, since the gain to the shareholders is the net growth in their assets at the end of the year over assets at the beginning of the year. On this basis, all gains, whether operating or capital, would be included in the year's income, and the net asset growth over a period of years could be arrived at by adding the published income figures for the respective years. It would be necessary to divide the income statement into two parts, one for regular profits and one for abnormal or non-recurring items.

Dependence on Management

Within industrial organizations it is not possible for individuals to retain freedom of judgment at all times. Employees depend upon the employer for daily bread, and their opinions or judgments are often coloured according to the expected reaction of their immediate superior. No matter to what extent the industrial accountant may agree with given principles, he will invariably conform with the desires of management, unless he is fortified by a courageous stand taken by the accounting profession. In other words, if industrial and professional accountants are to work together, rather than at cross purposes, it is necessary to achieve dynamic leadership in the profession, a leadership that will give clear and definite opinions on current accounting problems, without fear of hurting the feelings of the reactionary minority of members or clients. The profession will find that industrial accountants are willing, to give real assistance in the consideration of the various accounting matters that come up for discussion.

Need for Standards

The greatest apparent need of accountants is for clear and generally accepted standards or concepts of accounting, supported by dynamic and authoritative leadership in the profession. Revisions to the Companies' Act will be necessary if shareholders are to receive a really intelligible annual report—including brief, clear and approximated financial statements with, say, five-year comparisons of major figures, and an explanatory report by management enlarging on developments during the period and the statement of financial condition at the end of the period. Because of the limitation on independence within industry, public accountants must assume their full share of responsibility for the establishment of sound accounting principles

POST-WAR SUGGESTIONS

and practices, and for the preparation of informative reports on business operations. The alternative to voluntary improvement is rigid government control and prescription, which has already been tried in some countries with not altogether satisfactory results. We have an opportunity to set our own house in order and establish our own standards and concepts, but unless we grasp the opportunity without delay we may find that it has passed us by.

"Post-War" Suggestions Wanted

At the annual meeting of The Dominion Association of Chartered Accountants in August 1943, a Post-War Planning Committee was appointed, composed of A. B. Shepard, Toronto, chairman; T. V. Burke, Montreal; K. L. Carter, Toronto; J. G. Glassco, Toronto; and R. W. Sharwood, Montreal.

The particular problems referred to the committee for study were: Financial statements; companies' acts; and taxation. The committee is proceeding with the consideration of these problems and invites suggestions in regard thereto from members of the Association. It is requested, however, that any such suggestions be transmitted through the sub-committee on post-war problems appointed by the member's own Institute.

The names and addresses of the chairmen of such committees already appointed are:

Alberta—Fred A. Smith, C.A., 215 Sixth Avenue West, Calgary.

British Columbia—A. A. Fairnie, C.A., 1818 Marine Building, Vancouver.

Nova Scotia—A. M. Butler, C.A., 42 Vernon Street, Halifax; J. C. Nicoll, C.A., 130 Edward Street, Halifax.

Ontario—K. L. Carter, C.A., c/o McDonald, Currie & Co., 69 Yonge Street, Toronto 1.

Prince Edward Island—N. W. Higgins, C.A., 42 Greenfield Avenue, Charlottetown; T. E. Hickey, C.A., c/o White Star Laundry, Summerside.

Quebec—W. H. Campbell, C.A., 437 St. James Street West, Montreal.

Saskatchewan—G. G. Patrick, F.C.A., 103 Bank of Montreal Bldg., Saskatoon.

Book Reviews

"Dickinson Lectures in Accounting" by George O. May, Dickinson Lecturer, 1936-37; Sir Laurence Halsey, Dickinson Lecturer, 1937-38; and William A. Paton, Dickinson Lecturer, 1939-40. (Published by Harvard University Press, Cambridge, Massachusetts, 1943, cloth, 148 pp. \$2.00).

In 1929 the firm of Price, Waterhouse & Company established the Arthur Lowes Dickinson Fund at the Harvard Graduate School of Business Administration in honour of that eminent accountant and author of articles and books on accounting subjects. In 1936 the provisions of the fund were altered to provide for the appointment from time to time of a man outstanding in accounting to lecture at the Graduate School of Business Administration.

The lectures delivered by four of the Dickinson lecturers have been made available to the public by the recent publication of them in two small volumes.

These lectures are the work of leaders in accounting thought and men of wide experience in their own field. This in itself recommends the reading of these books by those engaged in or interested in public or corporate accounting.

Mr. May succeeded Sir Arthur Lowes Dickinson as senior partner of their firm and has for a number of years been a leader of thought and public discussion on accounting problems. Some of his writings have appeared in THE CANADIAN CHARTERED ACCOUNTANT. Here he discusses "Improvement in Financial Accounts" under three headings, namely, historical, the problem of uniformity and practical lines of improvement.

Sir Laurence Halsey explains "The Position of the Public Accountant in Relation to Business and Government in Great Britain". His discussions fall under two headings: The origin of the profession and its function in relation to limited liability companies and the function of public accountants in relation to public institutions, private individuals and government departments. It is a most interesting outline of the high position achieved by the profession and its varied responsibilities in Great Britain.

BOOK REVIEWS

Mr. Paton, Professor of Accounting at the University of Michigan, and a nationally known and respected teacher deals with "Recent and Prospective Developments in Accounting Theory." He considers accounts from the viewpoint of the various individuals and groups interested in them, accounts as a measure of performance, some of the limitations of interim statements, and costs and values of fixed assets and their relation to the determination of income.

"Dickinson Lectures in Accounting" by Charles A. Heiss. (Published by Harvard University Press, Cambridge, Massachusetts, 1943, cloth 82 pp. \$1.25).

The author served as controller of the American Telephone and Telegraph Company for twenty-two years, retiring from that position a few weeks before these lectures were delivered in April of 1943.

Mr. Heiss uses freely of examples from his own experience to illustrate a comprehensive discussion of the duties, responsibilities and functions of an administrative accountant in a large modern corporation.

This book will be of particular interest to the young accountant contemplating a career in the service of a large corporation and of interest in a more general way to all accountants.

H. S. MOFFET

"Industrial Accounting—War and Post-War Problems." This was the theme of the Twenty-Fourth International Cost Conference held last June in Boston, the proceedings of which now appear in the 1943 Year Book of the National Association of Cost Accountants. The book comprises 211 pages, and is sub-divided as follows: Sessions 1, and 2, War Contract Problems; Sessions 3 and 4, Wartime Industrial Accounting Problems; Session 5, Post-War Problems. The year book is available at \$3 per copy from the office of the National Association of Cost Accountants, 385 Madison Ave., New York.

"Notes on The Dominion of Canada Income War Tax Act, The Excess Profits Tax Act and The Wartime Salaries Order" by Arthur W. Gilmour, B.Comm., C.A., revised edition, November 1943. (Published by The Society of Chartered Accountants of the Province of Quebec, Montreal, P.Q., 1943, 156 pp. 50c.)

The Quebec Society has again prevailed upon Mr. Gilmour to give a series of lectures to their membership and students on income and excess profits taxes. A similar series of lectures was given last year and at that time Mr. Gilmour prepared very complete notes which the Society published and made available to the profession throughout Canada. The revised edition which has just been issued will be used as the basis for this year's series of lectures and explains the various taxes contained in the Dominion of Canada Income War Tax Act and the Excess Profits Tax Act as they apply to the year 1943.

These notes should be compulsory reading for all chartered accountants and their students. They will prove to be a particularly welcome guide to the student who is learning for the first time the intricacies of taxation and for the member who has been away from the practice for some time and finds it difficult to inform himself of the constantly changing requirements of the Income and Excess Profits Tax Acts. But it will also prove useful to the practitioner who is handling taxation problems every day. As the practising accountant knows only too well, it is not enough to keep abreast of changes in the Act and the published orders and regulations—it is also necessary to keep informed of new administrative practices. A careful reading of the notes is almost sure to bring to light some new administrative practices which have been developed to take care of conditions which are not specifically covered by the legislation or the regulations.

In addition, the practitioner will find Mr. Gilmour's notes a convenient reference work to keep to hand. For example, in it will be found a very convenient table showing the exemption which may be claimed for various degrees of relatives; a list of the strategic minerals recognized by the Income Tax Department for the special 40% deduction; particulars of the basis of determining taxation of members of the armed forces in Canada; the expectation of life table used by the Department in discounting the deferred 1942 tax which may be paid prior to 30th April 1944 and a detailed explanation of adjustments which should be made to standard profits for changes in capital employed.

J. R. M. WILSON.

Current Accounting Literature

A Summary Prepared by J. D. Campbell,
Chartered Accountant

BULLETINS

(1) Cost Accounting

Instalment Sales—Bulletin No. 4, Volume XXV, 15th October 1943, published by the National Association of Cost Accountants (385 Madison Avenue, New York), carries an article "Things Learned in Accounting for Instalment Sales of Electrical Appliances" by Herman W. Boozer in which case study is presented dealing specifically with the repossession problem; the cost of instalment accounting and collecting and the presentation of procedures for amortizing finance charges.

In discussing the question of repossession losses in the particular case in question the objective statistical bases used by the company in providing reasonable reserves are outlined in which it is pointed out that in instalment sales the oldest accounts do not represent the greatest potential losses. This is based on the fact that the major portion of the repossession occur in this particular case in the 6th month when the customer has an equity of about 25 per cent in his appliance. "The reserve should be measured as a percentage of the amount of sales during the preceding six months and not as a percentage of account balances presently outstanding."

In covering the question of the cost of instalment accounting and collecting the semi-fixed nature of these expenses to the size of the account handled is set out as the reason "relatively large finance charges are charged on small-instalment accounts not an indication of exorbitant interest rates".

The major portion of the article is devoted to a discussion of a procedure for amortizing finance charges since "finance charges are not earned income of the month in which the instalment contract is written". The simple reducing balance method is outlined illustrated by exhibits indicating its actual operation in the particular case examined. Where the costs of billing and collecting form a substantial factor in the earning of the financial charges the method adopted segregates the estimated costs of billing

and collecting which are spread on the straight line method, whereas the balance is amortized on the reducing balance method.

ARTICLES

(1) Post-war Reserves

Walter A. Cooper in an article "An Integrated Plan for Post-war Reserve Allowances" published in the September 1943 issue of *The Journal of Accountancy* (13 East 41st Street, New York), presents a suggested plan for the creation of a reserve designed to meet the requirements of industry due to readjustment in the post-war period and at the same time establish controls to prevent tax evasion or the improper loss of revenue to the taxing authorities.

The plan suggests that the taxpayer is given "broad, general elective authority to set aside, on his tax return as well as his books, what he regards as his post-war reserve requirements with reasonable limitation on the annual amount; is required to fund the reserve so that it will be available when the war ends (the government meanwhile having the use of the money) and, if he does not spend it within a reasonable time for the recognized purposes, he must readjust his tax position to what it would have been if he had been able to and did spend, during the war period, what was actually expended after the war ended".

(2) Depreciation

The following definition of "depreciation" is submitted by the Research Department of the American Institute of Accountants:

"Depreciation (noun) is a word of art used in accounting to describe a charge that is made currently against operations on account of the inevitable and indeterminate partial exhaustion, not preventable by expenditures chargeable to maintenance, of the useful life of instruments of production or distribution, or of a group or assemblage of such instruments whose useful life is limited, but is expected to extend over a number, usually not less than three, of accounting periods and is computed by one of a number of conventional methods, the common and essential characteristics of which are that they allocate an actual or estimated life in a rational and systematic manner and that they provide for any revisions that may be found necessary of estimates initially made."

(3) Corporation Income Tax

William J. Shultz in an article "Economic Effects of a Corporate Income Tax" published in the November 1943 issue of *Taxes—The Tax Magazine* (Commerce Clearing House Inc., 214 N. Michigan Ave., Chicago), covers the question of effects from the realm of prices to the effects upon savings and investment.

In covering the question of the effects upon prices the arguments advanced hinge upon the economic concept that prices are determined, other things being equal, by the costs of the marginal producer. As the returns to the marginal producer merely cover his costs, the imposition of this type of taxation will not affect prices and therefore cannot be shifted. The profits of the infra-marginal producers are considered as "efficiency rents" which arise as a passive consequence of prices which rents may be reduced by taxation without influencing the prices that determine them.

Where conditions of imperfect competition exist and a concern has maximized its income by equating marginal cost with marginal revenue, the added impost will not be reflected in increased prices as this step would lead to a net decrease in income after taxes.

The question of discrimination is considered both in respect to the unincorporated business as against the incorporated business and in respect to businesses with fluctuating profits. In the first instance the conclusion is drawn "that the corporate and personal income taxes in combination discriminate against incorporated enterprises and in favour of unincorporated concerns of comparable size". In the second case due to a corporate tax structure based on a yearly statement of profits the effective rate of corporation tax (loss years) taken over a long-term period exceeds the statutory rate.

In discussing the influence of a rising corporate income tax on corporate financing policies the trend towards a fixed charge debt where the fixed charges are allowed as a deduction for the determination of taxable income, and away from equity financing, the return on which is not an allowable deduction in the determination of taxable income, is mentioned. It is interesting to note that the present Canadian situation has not shown this pattern in that standard

profits are, other things being equal, reduced by capital stock reductions.

The question of savings and investment is considered in some detail including the question of corporate dividend policy, retained corporate earnings and governmental expenditure programs.

"In contrast, all forms of federal taxation that are shifted into prices influence consumption expenditure more and savings less than does the corporation income tax."

(4) Accounting and Regulation

George O. May in an article "Accounting and Regulation" published in the October 1943 issue of *The Journal of Accountancy*, discusses the present relationships which exist as between accounting principles and the regulatory policy and sets out in conclusion the opportunity which exists for the profession to recapture not only lost ground in the field of control over accounting rules but also to render a public service in so doing.

The major portion of the article is devoted to illustrating the extent to which regulatory commissions over accounting have succeeded in establishing discredited practices—"This is true of the non-acceptance of the cost amortization concept of depreciation; of reappraisal and improper charges against capital surpluses resulting therefrom; of pyramiding of holding companies; of periodical stock dividends improperly accounted for; and of the practice of charging to surplus, items which more properly belong in the income account."

In concluding it is pointed out that although regulation permits "freedom from responsibility" the profession cannot render its full service to the community by adopting such a policy. "It can do so by a policy which will combine with a willingness to co-operate with regulatory bodies to the fullest possible extent, acceptance of a responsibility for the maintenance and wise development of accounting rules and principles in the broad public interest . . . there should be accepted a collective obligation to be independent in their relation to commissions."

(The above article represents in substance the last chapter of a book by George O. May "Financial Accounting—A Distillation of Experience.")

(5) Research and Education

The leading article of *The Accountant* (London) Volume CIX, No. 3592, 9th October 1943, captioned "Research and Education" outlines briefly the part which research is to play in the post-war reconstruction period as applied to both the industrial as well as the professional field.

In discussing the need for research within the accounting profession reference is made to the article "The Future of the Profession" by Mr. de Paula published in the issue of the 8th May 1943 in which he advocates "full-time research by specially selected personnel to study the many important problems that require thinking out if the accountant is to shoulder further responsibilities in the industrial field."

The question of adult education is raised in respect to which one aspect is pointed out as being of concern to the accountant namely "the desirability, or otherwise, of providing refresher courses at which practitioners may be kept up to date with developing thought and changing practice".

(6) Inventory Valuation

Leo A. Schmidt in an article "Control of Detail in Inventory Valuations" published in the October 1943 issue of *The Accounting Review* (Tappan Hall, Ann Arbor, Michigan), attempts to answer the problem—"How can the entries in the perpetual inventory accounts be handled so as to keep the book figures for the control and for detail accounts in agreement with each other, and, at the end of the period, to bring them into agreement with the inventory as priced under the various suggested methods?"

Six main methods of inventory valuation are examined, namely, actual costs of special items; first-in first-out (Fifo); moving average costs; market price; cost or market whichever is lower; and last-in first-out (Lifo). Special attention is devoted to the last three methods where the agreement of control and detail book accounts with the end-inventory valued on the basis of the method adopted lacks the almost automatic agreement which is present in the case of the first three methods.

In discussing the nature of the basis of the pricing of issues to be adopted under any method it is pointed out "In each case it is imperative for practical reasons to price

issues on that basis which will minimize the end of the period adjustment. To the extent that this cannot be accomplished under any particular method of valuation it must be considered as an inherent disadvantage of that method."

In considering the "Lifo" method of inventory valuation the discrepancies which arise in using this same basis for pricing issues made are considered with particular reference to the erratic charges which may result for material issues made to different jobs particularly where the issue is made from the basic inventory. The decision is reached that since there is no method of pricing out issues which is directly congruent with the lifo closing inventory valuation that a choice must be made between the available methods which may approximate the results intended by the "lifo" method. The method of pricing issues examined are namely "Lifo", market, last invoice price, and uniform issue price, and the conclusion is reached that a combination of the last invoice price and the use of a uniform price would be the most satisfactory.

(7) Income Statement

Arnold W. Johnson in an article "Form, Function, Interpretation of Profit and Loss Statement" published in the October 1943 issue of *The Accounting Review* presents a general review of the present day developments in accounting as applied to the income statement.

The general discussion of form and content is carried on against an over-all background of the growing significance of the income statement over the balance sheet. Performance rather than periodic financial position assumes the dominant place as the primary test of the success of the business enterprise.

In discussing the general form of the income statement it is pointed out that "The propriety of matching costs against incomes is well appreciated by intelligent accountants although the translation of this propriety into actual income statements has been somewhat slow."

The major portion of the article is devoted to consideration of the question as to "What should the income statement contain?" In this discussion of the question of content special attention is focused on the interrelationship existing between the income statement and the surplus

account, and particularly upon the question as to whether the general theory of the surplus statement—"that the statement of surplus shall contain those items not directly related to the basic and recurring operations of a period"—permits the construction of periodic statements which in themselves, adequately and conservatively measure the net income of these periods individually and collectively.

"In line with the current trend of accounting thought toward greater emphasis on the income statement, there has been increased advocacy and use of the comprehensive and consolidated income and earned surplus statements. This means simply that all incomes and income-costs and all losses are placed in the profit and loss statement in the year in which such items are realized in the accounting sense."

In closing it is pointed out that the dynamic responsibilities which the accounting profession assume in constructing the statements of their clients demand "that the accountant be constantly up to date, and that he be in harmony with the advancing thought of his profession, with statutory enactments, with his obligations to management, to stockholders and to society generally".

(8) War Accounting Practices

Stephen Gilman in an article "Reporting of War Accounting Practices" published in the September 1943 issue of *The Journal of Accountancy* presents a review of certain interesting accounting problems in procedure and report presentation based on a survey made of certain 1942 annual reports of selected corporations.

The problems discussed in the article cover the following: Income tax as an operating expense, post-war refunds, war reserves, renegotiation, advances, deposits and progress payments, receivables and inventories, surplus adjustments and sundry observations.

In the examination made of the item of war reserves it is pointed out that "In most instances the provisions for such reserves were made from income as one of the final items in the statement". The manner in which each of the companies examined which disclosed wartime reserves is indicated.

In covering the question of post-war refunds the recent report of the American Institute of Accountants covering

this item is referred to in which 82 cases out of 90 revealing the item show the post-war refund in the income statement by "Deduction from income tax, including 21 cases where credit is shown parenthetically". From the balance sheet viewpoint 34 of the companies showed the post-war refund as a separate caption while 44 companies included it among "investments" or "other assets".

The following quotation taken from an audit report is submitted in reference to the audit procedures carried out in respect to inventories—"For inventories where it was impracticable to make any physical count without interrupting production of war materials, and which amounted to approximately 59 per cent of the total, we reviewed the cost records and other data supplemented by an analysis of the variances where physical inventories were taken. Provision has been made for inactive and obsolete stocks and for probable allowances or additional expenditures on completed contracts. Our examination satisfied us as to the substantial fairness of the amounts at which the inventories are stated."

In summing up the findings it is pointed out that "most of these problems have a distinct bearing upon the question which currently plagues all accountants, namely, the uncertainty of financial statements during war years".

(9) Differential Costs

E. A. Saliers in an article "Differential Costs" appearing in the October 1943 issue of *The Accounting Review* discusses the general theory underlying differential costs and indicates in a brief outline a suggested procedure for accumulating the necessary data.

Differential costs, an important consideration in budgeting, represent estimated costs of projected increased production the calculation of which is based on the known costs of present production which known costs are subdivided into two categories one of which varies with the plant size the other with production.

In discussing the preparation of differential costs, special stress is placed upon the necessary provision in such costs for any loss resulting from a price reduction arising from the marketing of the increased production. "Differential costs incident to increased production do not serve as a basis for estimating profits to be realized there-

on until such costs are increased by the loss arising from market exploitation incident to disposing of the increased output." Both marginal revenue and marginal cost must be considered in the determination of differential cost.

(10) Internal Auditing

John B. Thurston in an article "Internal Auditing and the Public Accountant" published in the September 1943 issue of *The Journal of Accountancy* discusses some of the major functions of the internal auditor covering the questions of internal control, the verification of the financial statements and the audit of government contracts.

In covering the function of the auditor in respect to the operation of the system of any internal accounting control it is pointed out and illustrated that "Despite the degree of perfection attained in the design of any system of internal accounting control . . . a technically trained man is required to watch it, maintain it, and improve it." An efficient system of internal control is based on a division of labour which requires the work performed by one person to be checked by another which in turn is based on the underlying assumption that collusion is non-existent. In the case of the underlying basis of division of labour and collusion circumstances indicate that the division of labour necessary may be too costly and that collusion does exist.

The discussion of the verification of statements brings to the front the question of the degree of reliance which should be placed upon the work performed by the internal auditor by the external auditor in drafting his audit test program. Proposals are submitted indicating ways and means of greater collaboration between internal auditors and the public accountants particularly under the scarcity of efficient manpower and other conditions which exist at the present time.

"Management should realize that internal auditing is not a luxury but a necessity. It is a necessity from the standpoint of war contracts . . . from the standpoint of verification of financial statements. But fundamentally and most importantly . . . from the standpoint of management itself, since without it management lacks one of the recognized means of control essential to the proper conduct of a business."

Letter to the Editor

REFUNDABLE PORTION OF INCOME AND EXCESS PROFITS TAXES

Sir:

In making a somewhat belated review of the June issue of The Canadian Chartered Accountant, I came upon the memorandum under the heading of "Refundable Portion of Income and Excess Profits Tax" on page 439 which is not consistent with the views of many chartered accountants, or of the Committee on Accounting Research of The Dominion Association of Chartered Accountants.

The gist of the article is that the refundable portion of the personal income tax should be omitted entirely from financial statements and that in corporations the refundable portion of the excess profits tax should be excluded from the accounts, the only reference being a footnote showing the amount of the refundable tax under the heading of contingent deferred assets. It even goes so far as calling the refundable tax a "deferred business expenditure."

To illustrate how entirely this is opposed to the recommendation of the Dominion Association's Committee on Accounting Research, I quote from their recommendation: (See page 140 of the February, 1943 issue of The Canadian Chartered Accountant): "Your Committee is of the opinion that it is not desirable to make reference to the refundable portion by way of a footnote but that, in all cases, the amount should be included in the Balance Sheet." Also, I should like to ask what, when analyzed, is a contingent deferred asset?

It surely must be clear to all readers that a definite obligation of the Dominion government such as the refundable portion of income and excess profits taxes cannot be omitted from statements any more than any other obligation of the government such as Victory bonds. The writing off of this asset against profits appears to be quite a departure from recognized accounting principles and, if followed by the profession as a whole, certainly would not help to bolster public confidence in the country's future.

In conclusion, lest I be accused of criticizing without suggesting a solution to the problem, I would suggest the following treatment:

PERSONALS

(1) Include in the liabilities the full amount of the tax until paid.

(2) Charge the net amount (gross tax less refundable portion) to profit and loss.

(3) Show the amount of the refundable portion of the tax as a deferred account receivable in the balance sheet.

In my opinion anyone following this procedure will come closer to exhibiting "A true and correct view of the state of a company's affairs" than by any other method. We must remember that, as chartered accountants, we are often looked to for leadership in financial matters and any advice given which might reflect on our country's ability to make good its obligations might have serious repercussions amongst the public at large; particularly at a time when so many are directly affected by taxes and refundable taxes.

JOHN A. WILSON,

27th October 1943

Toronto, Ontario.

Personals

Messrs. R. D. Hill, Bertram and Hector announce the dissolution of their partnership as from 31st October 1943.

Messrs. R. Douglas Hill, C.A., and R. C. Bertram, B. Com., C.A., announce that they have entered into partnership for the practice of their profession under the firm name of Hill and Bertram, chartered accountants, with offices at 448-449 Confederation Life Building, Toronto.

Mr. R. H. B. Hector, C.A., A.C.A., will continue practice under his own name at 546 Confederation Life Building, Toronto.

E. C. Leetham, chartered accountant, announces the admission into partnership, as at 1st January 1944, of John C. Newland, chartered accountant, and that from that date they will practise their profession under the firm name of E. C. Leetham and Company, chartered accountants, 1130-31 University Tower Building, Montreal, P.Q.

Discussion on Profit Control and Cost Audits of War Contracts

(Following the addresses on "Profit Control and Cost Audits of War Contracts" at the annual meeting of the Association, there was a brief question and answer period, the stenographic report of which is given below.)

A MEMBER: Under the Purchasing Act, Section 5, profits are limited to five per cent of capital?

MR. WILLIAMS: When the Department of Munitions and Supply succeeded the War Supply Board, which had succeeded the Defence Purchasing Board, the Act was changed. In the original act setting up the Defence Purchasing Board there was a provision, as you say, of five per cent on capital—it was limited. That is not in the present Act and no consideration has been given to it.

MR. F. E. WOOD: As to the matter of insurance, raised by a member, there are no forms of insurance premiums allowed on Crown property; in certain cases the contractor is instructed to carry insurance until the time the buildings are handed over to the Crown, and if so instructed the insurance on those buildings is allowed as an element of cost, but once the buildings are handed over the insurance is cancelled and the Crown takes over the risk. As far as fidelity insurance is concerned I am sorry I cannot call the answer to mind, but we have quite an elaborate memorandum from Munitions and Supply on various types of insurance setting out the kind of insurance which the department will recognize and other kinds which they will not, and we are guided by that in our cost determinations. Mr. Williams has called my attention to one point: In carrying out a specific audit where a company has continued a practice that has been in force for years the insurance premiums that are normally paid by the company are accepted as an element of cost in so far as they apply to specific contracts.

MR. CRAWLEY (ONTARIO INSTITUTE): The point was raised this morning about the cancellation clauses on contracts. I wonder if I could get a statement as to what settlement is going to be effected when contracts are terminated when the war is finished?

MR. WILLIAMS: That unfortunately, gentlemen, is

PROFIT CONTROL AND COST AUDITS OF WAR CONTRACTS

a question of government policy and I cannot discuss policy. I can go so far as to say this, that it is being given a good deal of consideration, not only by our department but by other departments in Ottawa. We have had representations made to us by various contractors. Cancellation of contracts will in the event of the cessation of hostilities become quite an important item. I am sorry that I cannot say anything more than that consideration is being given to it.

A MEMBER: On the memorandum M. & S. 433 it says there shall not be included discount or finance charges. What about the case of a company that borrows money from the bank in order to take advantage of cash discount? The company pays the interest but at the same time has got to give the cash discount benefit to the government; in other words they lose both ways.

MR. WOOD: The general policy of the department, and I might say as far as I know it is consistent with both British and American practice, is that any discounts taken by a contractor must be credited to the Crown, and at the same time they will not allow interest on bank loans for the purpose of carrying out the contract as an element of cost. The interest on loans is considered part of the profit; in other words, if the contractor has plenty of capital he doesn't need to borrow and retains the entire profit subject to what the Department of National Revenue may do to him. If he has insufficient capital and must borrow, part of his profit goes to pay the interest. If he did it on any other basis I think that you would all agree it would be quite unfair to the man who didn't have to borrow. If there are three contractors all figuring on the same kind of contract (let us assume that it is on a cost plus five per cent basis) and the first contractor happens to have a million dollars in the bank that he is not using, the second contractor has to go and borrow from the bank, and the third contractor has provided his capital through an issue of bonds, it would be quite unfair to say to the first man "Well we are still only going to give you your cost without interest plus five per cent" and to the other fellows pay them plus the interest plus five per cent.

The Chartered Accountants' Club of Ottawa

Reported by Eric Fricker, Chartered Accountant

At a meeting on October 27, 1943, about fifty members of the club were introduced to the fascinating background and story of the National Research Council by the acting-president, Dean C. J. MacKenzie, C.M.G., M.C., M.C.E., who was recently awarded the Sir John Kennedy Medal by the Engineering Institute of Canada as a mark of their high esteem of his outstanding work.

The speaker at the outset pointed out that there were many steps between original invention and industrial utilization, and unless an overall scientific organization existed in the country it was quite possible that the benefits of original inventions might be lost to the people.

A Canadian National Research Council came into being in 1916 but did little during the war; however, from 1919 to 1932 the Council supported research activities in various universities and by a system of scholarships to deserving students helped in building up the core of a well trained scientific corps, which has been able to play an important part in this war. The National Research Laboratories were formally opened in 1932 and when the war broke out in 1939 Canada had available well equipped laboratories ready for immediate war work and a permanent staff of under 300 well trained young scientists. This served as the skeleton of a staff which expanded to well over 1,600 in a few months.

It is most illuminating to learn that around 1934-5 the annual expenditure on research by some of the leading nations was roughly as follows: Russia, \$500,000,000; U.S.A., \$235,000,000; U. K., \$28,000,000; Japan—about double U. K. figures; Canada, \$2,000,000.

The National Research Council is under the jurisdiction of a Committee of the Privy Council with the Minister of Trade and Commerce as Chairman. The Council is not operated as an administrative department of the government and its scientific staff are not directly under the Civil Service Commission. The Council organizes large national projects by setting up associate research committees of experts selected from its own staff, other government departments, universities and industry. These experts plan and

THE CHARTERED ACCOUNTANTS' CLUB OF OTTAWA

direct the actual investigations. There are at the moment forty active associate committees. The National Research Laboratories, located on the south bank of the river at Ottawa, comprise four scientific research divisions; namely, physics and electrical engineering, chemistry, applied biology and mechanical engineering. Within these divisions a multitude of war activities have been going on in such fields as sound detection, optics, ballistics, explosives, textiles, food processing and aeronautics. All these activities have been conducted in close co-operation with the navy, army and air force technical personnel. It was also most encouraging to learn that the Research Council of Canada has liaison offices in the United Kingdom and the United States and that the fullest co-operation and pooling of information for the common benefit exists between the research institutions of these countries.

Dean MacKenzie's strongest plea which he wished to be intelligently understood was that any nation which neglects to develop and co-ordinate scientific research with industry is bound to be at a very heavy disadvantage, either in peace or in war and cannot hope to rank high as an industrial country. This has been proven time and again. The cost of such work, he claimed, was extremely small and ridiculously so compared with the tremendous benefits gained both directly and indirectly, which no country desiring to keep up-to-date and progressive can possibly afford to neglect.

The speaker was introduced by Mr. W. Hogben, and after the address followed by a question period, a hearty vote of thanks to Dean MacKenzie was moved by Mr. A. O. Adamson.

**APPLICATIONS FOR PERSONAL INCOME TAX
REFUNDS**

By an order in council passed 10th November 1943, approving a recommendation of the Treasury Board, the twelve-month time limit for applications for refund of tax deductions at the source is modified. The order in council reads as follows:

"The Board recommend, under the War Measures Act, that authority be granted to the Honourable the Minister of National Revenue to make refunds of amounts withheld under sections 91 and 92 of the Income War Tax Act notwithstanding the provisions of subsections 19 and 8 thereof respectively in cases in which he ascertains the taxpayers to be non-taxable in respect of the amounts so withheld."

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENTS

A question frequently asked by students, especially those in the more elementary stages of their studies, is: "When confronted in an examination with a problem calling for the preparation of operating statements and a balance sheet (after making numerous adjustments) ought I to set about the preparation of a working sheet with debit and credit columns for unadjusted trial balance, adjustments, profit and loss and balance sheet, or is there some less laborious technique which will ensure equal accuracy?"

The preparation of a working sheet such as is described in the question is a "fool-proof" procedure but enormously time-consuming and our opinion is that most examiners when setting a problem of this kind *without expressly calling for* a working sheet do not allow the time needed in its preparation. Indeed we would go further and express the conviction that use of this technique and other methods equally roundabout and diffuse is a frequent cause of failure in examinations. Most examiners want to know what a candidate can do when he is on his toes; not what he can do when given unlimited time and an opportunity of crawling around on all-fours. And so the question of an alternative method is pertinent.

The one which we ourselves employ when confronted with this sort of problem is to mark all necessary adjustments directly on the preliminary trial balance as printed on the examination paper. If \$400 of accounts receivable have to be written off as bad we would insert "- \$400" against both accounts receivable and reserve for bad debts on this trial balance; if \$1,000 of depreciation had to be allowed on plant we would add to the preliminary trial balance (at the top or bottom, whichever afforded space) the ledger title "depreciation of plant", insert as a debit balance against it the figure of \$1,000 and against the preliminary figure of "reserve for depreciation of plant" write +\$1,000. Any and every adjustment can be handled in this manner and when all have been so handled the preliminary

STUDENTS' DEPARTMENT

trial balance has become the final adjusted trial balance from which the statements can be prepared directly.

There are some who advocate marking each item on the trial balance with a symbol to indicate its place in the statements such as M for manufacturing account, T for trading account, B.S. for balance sheet and so on with any degree of refinement. Our own experience as an examination candidate leads us to believe, however, that it is quicker and more accurate to go completely through the trial balance as each successive part of the statements is under preparation, picking out by a process of reasoning those items appropriate to each part and striking off each item as it is transcribed on the statements.

These are no more than suggestions for an alternative procedure; the alert candidate if he makes any use of them will merely adapt them to a technique which he has worked out for himself.

* * *

While on the subject of examinations we would remind our readers that examiners are human and that they respond favourably to a candidate who does his best to help them in their difficult task by writing legibly, paying attention to punctuation and employing the mechanical aids of sectionalizing, indentation of paragraphs, spacing between answers and separate parts of answers, and so on. There may or may not be a great number of marks specifically allotted to these seemingly trivial things and yet failure to pay attention to them may create a generally unfavourable impression in the examiner's mind and cost the candidate dearly.

* * *

STUDENTS' ASSOCIATION NOTES

BRITISH COLUMBIA

The Institute of Chartered Accountants of British Columbia regrets to announce that Bernard Joy Moffatt is now for official purposes presumed dead.

Born at Fernie, British Columbia, December 13th, 1917, he attended Fernie Public School and after moving to Richmond Municipality, adjacent to Vancouver, attended Richmond High School. On completion of his scholastic studies Bernard was articled to Mr. W. J. Barrett-Lennard, of the firm of Foster & Barrett-Lennard, chartered account-

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ants, in April, 1936. He joined the R.C.A.F. in February, 1941, was trained as an observer and received his commission as Pilot Officer at Christmas, 1941. He was reported missing early in November 1942 in air operations from Malta. Subsequently his promotion to Flying Officer was announced.

Bernard leaves to mourn his loss his parents, Mr. and Mrs. A. J. Moffatt and one sister Sheila, as well as his many friends and associates.

Bernard was capable and enthusiastic in all he undertook. His loss brings home to those who knew him the price of supreme sacrifice.

PROBLEMS AND SOLUTIONS

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1

INTERMEDIATE EXAMINATION, DECEMBER 1942

Accounting II, Question 3 (20 marks)

The following is the general ledger trial balance of Sunset School District as at 31st December 1941, before closing:

	Dr.	Cr.
Land	\$ 30,000	
Buildings	140,000	
School equipment	10,000	
Salaries—teachers	32,000	
Salaries—officials	1,000	
Light and heat	3,500	
Insurance	1,500	
Bank—current account	350	
Bank—loan account		\$ 50,000
Provincial government grant — collections during year		10,000
Municipal tax levy—collections during year		45,000
Debentures		112,000
Debenture interest	3,250	
Bank interest	3,500	
Stationery and supplies	2,500	
General expense	1,500	
Reserve for depreciation—buildings		3,500
Reserve for depreciation—equipment		600
Surplus—31st December 1940		8,000
	<hr/> \$ 229,100	<hr/> \$ 229,100

STUDENTS' DEPARTMENT

The following information has been obtained from the records:
For the year 1941 the municipal tax levy was set at \$50,000, and
the provincial government grant at \$16,000.

The following outstanding items as at 31st December 1940 were
not recorded on the books:

Municipal tax levy—balance owing	\$20,000
Provincial government grant—balance owing	5,000
Accounts payable:	

School supplies	250
General expense	150
Accrued interest on debentures	1,850

Accounts payable as at 31st December 1941 were as follows:	
Light and heat	\$300
School supplies	150
General expense	200

Depreciation is to be provided on buildings at $2\frac{1}{2}\%$ and on school equipment at 10% per annum.

School equipment purchased during the year amounted to \$4,000.
Debentures maturing 1st January 1941 amounting to \$2,000 were paid.

Accrued interest on debentures at 31st December 1941 amounted to \$5,320. The bank loan remained unchanged throughout the year.

Required:

From the above information prepare for presentation to the trustees of this school district the following statements:

- (a) Statement of cash receipts and disbursements for the year ended 31st December 1941
- (b) Statement of revenue and expenditure for the year ended 31st December 1941
- (c) Balance sheet as at 31st December 1941.

SOLUTION

CONSOLIDATED SCHOOL DISTRICT

STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS

for the year ended 31st December 1941

Balance on hand, 1st January 1941	\$ 100
Receipts	
Provincial government grant	\$10,000
Municipal tax levy	45,000
	<hr/>
	55,100
Disbursements	
Salaries—teachers	32,000
Salaries—officials	1,000
Heat and light	3,500
Insurance	1,500
Debenture interest	3,250
General expense	1,500
Bank interest	3,500
Stationery and supplies	2,500
Equipment purchased	4,000
Debentures matured and paid	2,000
	<hr/>
	54,750
Balance on hand, 31st December 1941	\$ 350
	<hr/>

THE CANADIAN CHARTERED ACCOUNTANT

STATEMENT OF REVENUE AND EXPENDITURE

for the year ended 31st December 1941

Revenue			
Municipal tax levy	\$50,000		
Provincial government grant	16,000		\$66,000
 Expenditure			
Salaries—teachers	32,000		
Salaries—officials	1,000		
Heat and light	3,800		
Insurance	1,500		
Debenture interest	6,720		
General expense	1,550		
Bank interest	3,500		
Stationery and supplies	2,400		
Depreciation, buildings 2½% p.a.	3,500		
Depreciation, equipment 10% p.a.	1,000		56,970

Net revenue for year, carried to surplus account \$ 9,030

CONSOLIDATED SCHOOL DISTRICT

BALANCE SHEET

as at 31st December 1941

Assets			
Royal Bank of Canada—current account		\$	350
Accounts receivable			
Provincial government grant—balance	\$ 11,000		
Municipal tax levy—balance	25,000		36,000
 Property and equipment			
Land	30,000		
Building	\$140,000		
Less: Reserve for depreciation ..	7,000		133,000
 Equipment	10,000		
Less: Reserve for depreciation ..	1,600		8,400
			171,400
			<u><u>\$207,750</u></u>
 Liabilities			
Royal Bank of Canada—loan		\$	50,000
Accounts payable			650
Debentures		\$112,000	
Accrued interest thereon		5,320	117,320
 Surplus			
Balance, 31st December 1940	8,000		
Add—Items outstanding 31st December 1940, not recorded			
Municipal tax levy	\$ 20,000		
Provincial government grant	5,000		
			25,000
Less—Payables and accruals	2,250		22,750
			<u><u>30,750</u></u>
Net revenue for year		9,030	39,780
			<u><u>\$207,750</u></u>

STUDENTS' DEPARTMENT

PROBLEM 2
FINAL EXAMINATION, DECEMBER 1942
Accounting IV, Question 4 (25 marks)

The Pioneer Finance Company has been in business since 1st May. At 31st October, the end of the first six months of operation, the directors are anxious to know what, if any, profit has been realized during the period.

The following balances are extracted from the general ledger at 31st October.

	Dr.	Cr.
Contracts discounted, balance outstanding	\$1,185,310	
Expenses, including salaries	26,520	
Service charges		\$88,866
Furniture and fixtures	10,700	

Total contracts discounted since the commencement of business, by months, have been as follows:

Month	Amount
May	\$ 126,000
June	315,600
July	287,100
August	288,300
September	252,600
October	211,500
	<u>\$1,481,100</u>

All contracts call for equal monthly instalments over a twelve-month period.

Examination of the contract ledger shows that arrears at 31st October consist wholly of instalments due in October on contracts written as follows:

Month	Face value of contracts
June	\$ 9,600
July	8,460
August	12,060
September	3,300
	<u>\$33,420</u>

There are no probable reposessions or bad debts.
Required:

- (a) Computation of earned service charges (do not carry computations beyond the nearest dollar).
(b) Profit and Loss account, after allowing depreciation on furniture and fixtures at 10% per annum.

SOLUTION

Since the service charge, \$88,866 represents 6% of the total contracts discounted \$1,481,100, the service charges for the several months can be computed as:

May	\$ 7,560
June	18,936
July	17,226
August	17,298
September	15,156
October	12,690
	<u>\$88,866</u>

THE CANADIAN CHARTERED ACCOUNTANT

The normal basis of allocation being on the "declining investment" method, the portions to be taken into earnings (as collected) might be computed: 1st Instalment—12/78 of service charge; 2nd Instalment—11/78; 3rd Instalment—10/78 and so on. (The numerator 78 is the sum of the arithmetical progression 12, 11 10 2, 1.)

The total of earned service charges, assuming all payments made when due would appear thus:

<i>Contracts</i>	<i>Dated</i>	<i>June</i>	<i>July</i>	<i>Aug.</i>	<i>Sept.</i>	<i>Oct.</i>	<i>Total</i>	<i>Total Service Charge</i>	<i>Earned</i>
	May	12/78	11/78	10/78	9/78	8/78	50/78	\$ 7,560	\$ 4,846
	June		12/78	11/78	10/78	9/78	42/78	18,936	10,196
	July			12/78	11/78	10/78	33/78	17,226	7,288
	August ..				12/78	11/78	23/78	17,298	5,101
	September					12/78	12/78	15,156	2,331
									\$29,762

A deduction should be made for payments in arrears as follows:

June contracts	
9/78 x \$576.00	\$ 66
July contracts	
10/78 x 507.60	65
August contracts	
11/78 x 723.60	102
Sept. contracts	
12/78 x 198.00	30

<i>Earned Service Charge to 31st October</i>	<i>\$29,499</i>
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<i>Profit and Loss Account</i>	
Earned service charges	\$29,499
Expenses, including salaries	\$26,520
Depreciation of furniture and fixtures	535

<i>Net profit</i>	<i>\$ 2,444</i>
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(Note: It is recognized that there are alternative methods of computing the earned service charges.)

Error

In the solution to Problem II of last month's issue the dividend figure of \$227.50 should have read \$113.75.

Obituary

The Late F. Lansdowne Belyea

The Institute of Chartered Accountants of Prince Edward Island regrets to announce the death of F. Lansdowne Belyea on 30th September at Montreal.

Mr. Belyea founded the firm of Belyea, McNiece & Company and served on the council of the Institute during 1942-43.

To Mrs. Belyea and son, Philip Lansdowne, the members extend their sincere sympathy.

